American economic association

[Report of the committee of five, appointed in...

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EXPLANATORY NOTE.

At the Annual Meeting of the American Economic Association held at Cleveland in December of 1897, it was voted to appoint a committee of five to consider and report upon the subject of Currency Reform in the United States. The committee appointed consists of Professors Taylor of the University of Michigan, Taussig of Harvard University, Jenks of Cornell University, Sherwood of Johns Hopkins University, and Kinley of the University of Illinois. The Report of the Committee will be presented at the coming meeting of the Association in New Haven, Dec. 29. It is given below in full. Should any important change be made at the final meeting of the Committee, Dec. 28, it will be wired to the Associated Press.

TO APPEAR DEC. 29.

To the American Economic Association:—

Your Committee to whom was assigned for consideration the subject of Currency Reform in the United States, beg leave to report that they have agreed upon a series of statements with respect to the need, the ~~objects~~, and the methods of such reform, which it is believed ~~would~~ command the assent of economists generally, and which may with advantage be published as embodying what might be called professional opinion. The following propositions, therefore, are submitted, with the recommendation that they be printed as part of the proceedings, but with the express disavowal of any responsibility on the part of the Association for the views therein set forth.

I. THE NEED OF REFORM.

Despite the fact that much improvement has taken place within two or three years, there still exists a real need for monetary and banking reform in the United States. The standard of value upon which the whole system rests is by no means as secure as it should be. The circulating note system is still greatly lacking in elasticity. Adequate banking facilities for newer, or more backward, districts are still wanting. In the system as a whole, there is a notable lack of unity and organization.

In citing the first particular, i. e., the insecurity of the monetary standard, as a proof that currency reform is needed, your committee do not mean to imply that the existing standard is the only possible one, or even the most desirable one. It is merely assumed that, so long as that standard is retained, it should have the utmost possible security; since the unquestioned security of the monetary standard is indispensable to a high degree of industrial prosperity.

It is possible, however, to argue that the defect in question no longer exists,—that the stability of the gold standard is now substantially assured. There is unquestionably much force in this contention. Besides a number of temporary circumstances, such as a full treasury, a large gold reserve, and a favorable trade balance of exceptional amount, several changes of a more permanent character have contributed to the improvement of the situation. We cite particularly the repeal of the provision in the act of 1890 to issue treasury notes in purchase of silver, and the insertion in the war revenue bill of a clause which authorizes the Secretary of the Treasury to make loans at his own discretion to meet temporary deficits. In fact, under the laws now in force, a Secretary who desires to maintain the gold standard need have no difficulty in doing so. But this is only one side of the case. It is equally true that, because of inconsistencies in these same laws, it is possible for a Secretary so disposed, to overthrow the gold standard, even though it continue to be the declared policy of the Nation to maintain that standard. There thus remains in the situation an element of [illegible], which is needless, and which cannot but [illegible]ful.

[illegible] respects the need for elasticity in the note system, next to nothing has been gained. In the first place, we still retain for our bank circulation the system of bond security, and under that system it is in the nature of the case extremely difficult, if not impossible, to secure in the currency that prompt and easy adjustment of volume to need which constitutes genuine elasticity. In defense of this statement much might be said, but it may suffice to call attention to a single consideration. If bank circulation is to be elastic, the assets which are required as security for that circulation must be such as a bank ordinarily has in its possession; since, in a stringency when expansion is needed, the bank already has its resources locked up, and consequently can not without great difficulty get hold of new assets. But government bonds are not a kind of assets which banks will, or usually ought to, have on hand in considerable amounts. The special office of banks is to provide funds for the everyday business of the country, i. e., to invest their resources, not in a supply of bonds to furnish the basis of a possible issue of notes, but in commercial paper, grain bills, and the like. As a result of all this, the amount of notes which, under our system, most banks issue, is that amount which can be kept in circulation substantially all of the time. Fluctuations in the need for such notes, there is almost no attempt to meet.

In the second place, we have not attained in our circulation even that degree of elasticity of which a bond secured system is capable. At the outset, we disregard the fundamental principle that, in order to be elastic, a circulation should be profitable. That this *is* a fundamental principle, needs little proof. The necessity of profitableness to secure expansion, is self-evident. In securing contraction, on the other hand, profitableness, if less necessary, is not less effective; for, in making each banker anxious to expand his own circulation, it leads him promptly to send home the issues of his neighbors in order to make room for his own. Thus, from the single fact that the circulation is fairly profitable, are derived two opposing forces which work respectively for the expansion and for the contraction of the currency as a whole. Further, the relative strength of these opposing forces is largely determined, as it should be, by the needs of business. If more notes are wanted in the ordinary circulation, they will be swifter in going out, and, since they will not naturally get into the hands of bankers, slower in being sent home to the issuer. If, on the other hand, fewer notes are needed, they will be slower in going out and more prompt in coming back; since, when idle, they will naturally accumulate in the banks, and by them will be sent home. It is thus evident that a reasonable degree of profitableness is a most important requisite of an elastic currency. Now it is a commonplace that our bank circulation is not a profitable one. Most banks deposit bonds to the least amount permitted by law, and do not always issue even the quantity of circulation corresponding thereto. It is ~~true that conditions have~~ in this respect measurably improved, the lower price at which bonds are now available having rendered the conditions of issue somewhat more profitable; but it is practically certain that this process has not been carried sufficiently far to furnish the necessary conditions for an elastic currency.

But again, even an increase in profitableness can not avail unless the machinery of issue and redemption is efficient. The forces which work respectively for expansion and contraction must have easy and unimpeded action. At this point our present law is not only inadequate, it is positively evil. It limits the amount of circulation which may be retired during any one month, and prohibits reissue for six months after retirement, thus actually putting a premium on inelasticity. Further, the machinery of issue and redemption is unnecessarily slow and clumsy. Even if a bank decides to expand its circulation, the process can seldom be completed till the special need has passed. In like manner, contraction can not usually be brought about till long after a plethora has worked much harm.

The foregoing remarks have more especial reference to the experience of ordinary times; for the case of the monetary panic, when there arises a demand for an immediate and very great increase in the stock of current moneys, absolutely nothing has been done. We thus have every reason to expect that, should another crisis as serious as that of 1893 overtake the Nation, we should experience a monetary famine of equal severity, and should again be obliged to resort to numerous extemporized devices very doubtful as to their legality and still more doubtful as to their efficiency.

What has been said concerning the continued lack of security and elasticity applies in substance to every other recognized need of the monetary system. Almost no progress has been made. It thus becomes evident that the only method by which we can insure that, when less favorable conditions arise, there shall be no recurrence of the disasters formerly experienced, is to bring about some more or less fundamental changes in the monetary system itself.

II. THE SECURITY OF THE STANDARD.

Under existing conditions, the only wise and consistent policy for the United States is the frank recognition of the fact that the actual monetary standard is now, and for some time to come will be, gold, and the adoption of legislation which shall insure the entire stability of that standard, until such time as the Nation ~~may have decided to establish~~ some other. Assent to this statement does not commit any one to the position that the gold standard is, abstractly considered, the most desirable one. As is well known, a large number of economists hold to the opposite opinion. But, as is also well known, the particular substitute which such economists favor, i. e., international bimetalism, is at present, and for a long time will be, out of the question. In consequence, the precise form which the question of standards now takes in the United States, is as to whether the currency shall rest on a gold basis, or on a silver or paper basis. Thus stated, it can have, to the majority of economists, but one solution. Under existing conditions, the gold standard is, for the United States, the best available. This being the case, it is the duty of the Nation to render that standard as stable as possible and to remove all uncertainty as to its maintenance and its easy working; for uncertainty as to the basis of the currency must always be a menace to prosperity.

With respect to the means through which increased stability for the standard shall be insured, it is hardly to be doubted that much would be gained by its explicit definition in terms of gold. Still more important would be the enacting of such legislation as shall insure that the task of maintaining the standard, or, in other words, of maintaining the convertibility into gold of other forms of currency, shall be efficiently performed. At this point, your committee find themselves in accord with the commonly received opinion that, under normal conditions, the task in question can most advantageously be devolved upon some institution or institutions of a banking nature. We are also agreed, though perhaps less positively, that, even under the conditions which must prevail in the United States, this same solution of the problem is, on the whole, best. If, however, this plan shall prove impracticable,—if the task of maintaining the standard of value is still to rest upon the Treasury,—everything calculated to make that task an easier one should be done, and the department should be specially organized with reference to the duty thus devolving upon it, and provided with such additional powers as are necessary to insure its fitness for the work in hand. Among the various changes which would tend to the accomplishment of these objects, your committee believe the most important to be some modification of the existing system whereby the duties of the Treasury as respects the management of the monetary system of the country shall be separated from those functions which are of a purely fiscal nature. It would doubtless be well, also, to find a place for silver where it will cause least trouble, by retiring all notes under ten dollars, and to authorize the Secretary to withdraw, at least temporarily, United States notes which have been once redeemed. If it should be decided not to establish a separate issue department, at least the function of the Secretary in maintaining the parity of gold and silver should be made obligatory.

III. THE BANKING SYSTEM.

A. Elasticity.

Whatever decision may be reached with reference to the much disputed question as to whether United States legal tender notes shall continue to hold their place as part of the paper currency of the country, it is certain that the maintenance of some system of bank issues will be indispensable. This system should, without doubt, be under federal control and should take such form as to insure much greater elasticity than exists in the present system, provided always that the security of the issue shall be in no wise impaired.

As respects the method to be employed for attaining this needed increase in elasticity, it is believed that the really successful one must involve issuing some portion of the circulation upon ordinary banking assets. The chief reason for this, as already indicated, is that such ordinary banking assets are the only ones which are universally and readily available when expansion is needed. The superiority of such a system is further insured by the fact that there is a very close correspondence between the amount of such assets in the possession of the banks and the need of the community for currency; since these assets, like the need for money, vary in amount with the volume of business. As respects the security of such notes, there need be no anxiety, provided the system is supplemented with the device of a safety fund, or with one or more of the various other expedients which have been proposed. If it be urged that nothing can make this system really safe, at least for the banks considered as guarantors of each other's notes, so long as the securities on which those notes are based remain in the custody of the issuing bank, the objection might be met by enacting that notes of this character shall be issued only through Clearing House Associations which are to hold in trust the commercial paper or other collateral by which the notes are secured, just as they now do in the case of loan certificates, and as the Treasury of the United States does in the case of national bank notes.

It may, however, prove impossible to secure legislation of the character described. In such event the existing system of notes based on United States bonds should be so amended as to give to it as large a measure of elasticity as is possible. The provisions of the law of 1882 which limits the amount of notes that may be retired in any one month, and prohibits reissue within six months after retirement, should be repealed. To secure in some degree that increase in profitableness which, as we saw earlier, is indispensable to elasticity, it would be well to raise the ratio of notes to bonds deposited and to lower the tax, or, better still, to levy it on capital and surplus. In order still further to [illegible] the self-interest of the banks, especially on behalf of the prompt retirement of redundant notes, we should be inclined to prohibit any bank from paying out the notes of any other bank except to the issuer or to the redemption agency. As respects making easier the processes of expansion and contraction, some gain would result from requiring the Comptroller to keep on hand a supply of notes in blank, and still more from an increase in the facilities for redemption.

In order to furnish the sort of elasticity which is needed in a panic, it is even more necessary than in ordinary times to depend on general banking assets for the security; since at such times few banks have any resources left with which to purchase government bonds. To insure that some portion of the power of issue should be reserved for such occasions, as also to secure its prompt retirement after the special need has passed, there is probably no better expedient than that already tried in Germany, i. e., levying on such circulation a tax so high as to be in ordinary times prohibitive. It would seem that the natural way to apply this general plan both safely and effectively, would be to intrust its elaboration and management to the Clearing House Associations, which have already worked out an analogous scheme in the Loan Certificates that have done much service in former crises.

B. Country Banking.

As already remarked, there is a real need for increased banking and currency facilities in the newer or more backward parts of the country, and legislation could do something towards satisfying this need. In the judgment of your committee, the most effective as well as the safest expedient for accomplishing this object is some system of branch banking so constructed as to supplement, but not displace, the present system of independent banks. Under such a plan, banking facilities can be furnished to communities too small to support even the smallest independent bank of issue; and capital can be most cheaply and easily transferred from districts oversupplied to those needing it; while, at the same time, the dangers of fraud or mismanagement incident to all banking are far less serious than under a system of small independent banks. There are doubtless objections to the plan; but the experience of other countries has shown that they are not of great moment.

If, however, the apparent tendency towards excessive concentration of capital shall prove too strong an objection to this system, other alternatives offer themselves. A decision to permit the issue of any portion of the circulation upon general assets would greatly increase the banking facilities of the country districts; since the chief obstacle at the present time to the establishment of national banks of issue in such districts is to be found in the circumstance that they could not afford to invest their capital in assets so unproductive as United States bonds. Another, but rather more doubtful, remedy for the difficulty in question, would be the exemption from the federal ten per cent. tax on circulation, of such state banks as should comply with the regulations of federal law and submit to federal supervision. This change would, without doubt, greatly increase banking facilities,; and, probably, it would prove quite safe. Again, a lowering of the minimum capital for a national bank from the present figure to twenty or twenty-five thousand dollars would be better than nothing, and would probably work no evil effects of any moment.

CONCLUSION.

In conclusion, your committee cannot refrain from expressing the conviction that it will be a genuine misfortune if the very notable movement toward monetary reform which has filled so large a place in the history of the last few years, shall pass away without having left any results in legislation. Never before have there existed among all classes so great an interest in this subject, so near an approach to unanimity of opinion, and so strong a purpose to see something acomplished. To this very promising attitude of the public mind, are added external conditions of an extremely favorable character. We allude to the exceptionally large stock of gold both in the treasury and in the country at large, to the unprecedented trade balance, to the generally solid condition of business, to the absence of any necessity for that haste which always makes legislation in a crisis dangerous, and, not least, to the approaching control of all departments of the national government by a single political party. A conjuncture in so many respects favorable, we can scarcely hope to meet again in the near future. Its utilization would, therefore, seem to be commended by every consideration of prudence and good judgment.

Without doubt, there are still considerable obstacles in the way of reform. It is easy, however, to exaggerate the seriousness of those obstacles. Your committee wish particularly to remark this in respect to the much-noted divergencies of opinion among friends of reform. The not uncommon opinion that these divergencies are so serious as to render hopeless the prospects of reform, we consider quite unwarranted. As a matter of fact, barring differences due to the circumstance of some being more, others less, radical, the various projects of reform have a surprising similarity. Doubtless there are differences of method so fundamental that the choice of one plan involves the rejection of its rivals; but cases of this sort are comparatively few. An analysis of a large number of plans of reform discloses the fact that, of the various expedients proposed in them for accomplishing the several objects sought, a considerable proportion appear in nearly every one of the plans.

In the light of these facts, your committee are of the opinion that what is most needed at this juncture, is a disposition on the part of the friends of reform to sink individual preferences as to details, and to insist that Congress shall enact such legislation as it may be possible to agree upon. Undoubtedly, there is room in this matter of currency reform, for honest differences of opinion, but such a degree of persistence in one's opinion as makes a working compromise impossible has no justification in monetary principles or in the conditions prevailing in the United States. It is safe to say that, of the five or six currency bills that, during the last twelve months, have been in any serious sense before the country, the passage of any one would have resulted in great improvement and would have measurably satisfied the demands of reformers.

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